

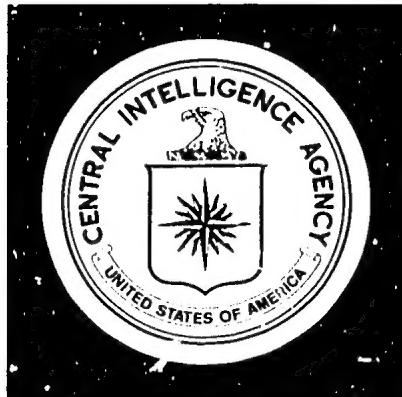
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation in South Vietnam

USAID review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
January 1973

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

SUMMARY

1. South Vietnam's economic performance in 1972 was better than might have been expected in view of disturbances from the North Vietnamese offensive, bad weather, and the continuing US troop withdrawal. The rapid production gains of 1971 were halted, but inflation was held within reasonable bounds, major progress was achieved in both tax reform and collection, and exports rose sharply.
2. Commodity prices in Saigon have remained quite stable since early December. Black market currency and gold prices, however, have generally been rising. Sharp fluctuations in gold prices in mid-January were attributed to large-scale smuggling by a group of buyers from Hong Kong.
3. Following the ceasefire the Viet Cong apparently intend to use such economic incentives as loans, land, and free food and tools to lure people into areas they control. Within selected government-held areas, they hope to create dissatisfaction by buying up goods, thereby causing shortages and inflation.
4. Charts showing major economic indicators and the government budget (Figures 1 and 2) follow the text.

Note: This memorandum was prepared by the Office of Economic Research.

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CONFIDENTIAL**DISCUSSION****The Economy in 1972**

5. The North Vietnamese offensive stalled South Vietnam's economic growth and led to a recession in 1972. In contrast to the 1968 Tet offensive, however, there was considerably less damage to productive facilities, and the government was better able to cope with both the human and economic problems that resulted. Prices increased 24%, a rate of inflation that should be considered relatively modest. Moreover, considerable progress was achieved on several fronts, including revenue collections, tax reform, and exports.

Industry

6. Industry suffered most from the offensive, not because of physical damage to plants but because of a falloff in demand for its product. Before the start of the March offensive, many Saigon manufacturers and importers were carrying larger than normal inventories which were financed at fairly high interest rates. Having overestimated demand for their wares, they were caught in a credit squeeze. In these circumstances the offensive came as a particularly severe blow to many firms. Consumers reduced their purchases, business activity declined, and investment plans were canceled or postponed. Many small firms closed and larger ones were forced to cut back working hours or reduce wages. Only those with government contracts or US military procurement orders for such items as textiles, canned goods, and batteries are producing at near normal levels. No significant revival of demand has yet occurred, because the uncertainty about the military situation has now been overtaken by concern about the ceasefire. When the figures are in, both manufacturing and construction probably will show considerable declines in output for 1972.

Agriculture

7. Agricultural activity was pretty much undisturbed in many parts of the country during 1972, although some areas did suffer from both the fighting and bad weather. The net result was that overall output probably remained at about the 1971 level. Hardest hit was rubber production, which was reduced by half as the result of the destruction of plantations in Military Region (MR) 3. The fish catch, on the other hand, apparently increased substantially, spurred on by exchange rate changes and world market conditions that stimulated exports. Forestry operations expanded very substantially during the first half of the year, but this pace probably was not maintained during the last six months because of a government ban on logging in several provinces during much of the period.

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8. The rice harvest, which is now in full swing, is expected to yield about the same size crop as last year's - 6.2 million metric tons of paddy.¹ Preliminary estimates show that increased output in the Delta will just about offset declines in other parts of the country. The area planted to rice declined very slightly, and yields reportedly are lower for both traditional and high-yield varieties. Production apparently will not decline as much as originally projected, however, because Vietnamese farmers continued to plant more high-yield rice.

9. Because of losses and transport problems caused by the offensive, domestic rice supplies had to be supplemented in 1972 with about 280,000 tons of imports, or double the 1971 level.² With the new crop no larger than last year's, agricultural experts are projecting import requirements of about 350,000 tons in 1973. This amount presumably will allow for the increase in population (and consumption) and permit the government to build up and maintain adequate stocks.

10. The three-year, one-million-hectare Land To The Tiller Program begun in March 1970 was only temporarily slowed by the offensive. Distribution of land to new owners regained momentum in July, and, as of the end of the year, 790,000 applications had been approved for 925,000 hectares. Officials seem confident that by the end of March the goal of one million hectares will be reached, although distribution of titles will still lag somewhat behind. No plans have been announced regarding land distribution after March, but the current size limits of three hectares per new owner in MRs 3 and 4 and one hectare in MRs 1 and 2 will probably have to be raised if any attempt is made to open up new lands. This is especially true for the western portions of MRs 2 and 3, where small tracts of land cannot be used efficiently because of the hilly terrain or because they are best suited for plantation crops or as grazing land for livestock.

Manpower

11. Although the offensive was the major reason for the severity of the business recession, the continuing withdrawal of US troops and completion of major US construction projects in mid-1972 also reduced demand for Vietnamese goods and services. Employment in the US sector

1. The official estimate for last year's (1971/72) crop was 6.3 million tons, but it was never changed to reflect losses from the offensive, estimated at about 100,000 tons.

2. The offensive, however, did not stall efforts to reestablish commercial marketing of Delta rice in the northern provinces. As the result of financial incentives offered by the government, private merchants shipped almost 100,000 tons of rice to MRs 1 and 2, compared with about 30,000 tons in 1971 and none in 1970.

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had declined steadily for about three years, but the largest drop occurred in 1972, when more than 50,000 Vietnamese were laid off by US agencies and their contractors. Additional thousands who were employed by US civilian and military personnel also were thrown out of work. The potential social and political impact of these layoffs has been muted by the following three factors:

- (1) One-half to two-thirds of those employed directly or indirectly by the US sector were women, many of whom were married and in a position simply to drop out of the labor force;
- (2) For those other than married women, considerable assistance has been provided through the traditionally strong system of Vietnamese family ties; and
- (3) Some have found full-time or part-time jobs outside the US sector.

Moreover, unemployment attributable to the US pullout has been masked by the recession and the large number of refugees. With 1.3 million people (about 7% of the population) driven from their homes during 1972 and more than 600,000 still living in government camps, the overriding manpower problem facing the government has been the care and resettlement of refugees.

Prices

12. Stabilization efforts in 1972 were more successful than might have been expected. Inflation was held to 24% - a modest rate in view of the many supply disruptions caused by the offensive and the increasing cost of imports with successive devaluations³ and higher world market prices. Unlike 1968, there was relatively little hoarding of goods or other speculative activity. This was probably due in large part to the success of the various economic reforms taken since 1970 as well as to greater consumer confidence in the government's capacity to deal with such problems.

³. During 1972 the piaster was devalued a total of 16%. The most recent devaluation occurred on 30 December when the rate rose 10 piasters to 465 piasters per US dollar. The special rate for imports financed under the US Commercial Import Program was also raised 10 piasters to 320:1. One overall effect of the devaluations and the higher world market prices was to reduce importers' profit margins somewhat, as indicated by the fact that their costs rose more than the prices they received.

13. Consumers did face sharply higher prices, however, for certain items such as petroleum products, fertilizer, and pesticides as long-time subsidies were reduced or eliminated. The large exchange rate subsidy on fertilizer imports, for example, was gradually reduced over the year and finally eliminated as of 1 January 1973. As a result, fertilizer prices more than doubled during 1972 and will again rise sharply when new stocks are ordered this year.⁴

Monetary and Fiscal Developments

14. The course of monetary developments in 1972 was very complex, and even its broad patterns are hard to trace because of the inadequacy of money supply statistics. While the official series (see Figure 1) shows that the money supply increased only 6% during January-November, the "true" rate of growth was considerably greater, probably near the rate of inflation.

15. In the early months of the year, there was an acute credit squeeze on importers and others holding large inventories of goods. For a time, this led to a fairly heavy business demand for piasters and an attendant appreciation of the piaster on the currency black market. The North Vietnamese military offensive added the complication of a higher-than-normal preference for cash and related declines in consumer demand and business activity. As a result of the ensuing recession, demand deposits fell some 20% over the year. At the same time, the combined total of savings and time deposits more than doubled, a rather surprising development considering that the average interest rate probably was about zero when adjusted for inflation. This gain is probably explained by: (1) a greater reluctance to hold inventories of goods in a deteriorating security situation; (2) savings/time interest rates that rose somewhat during the year; and (3) banks' willingness to allow savings deposits to be used increasingly like demand deposits.

16. Major progress was achieved in the fiscal field during 1972. Local government tax collections more than doubled (albeit from a small base), and central government revenues from domestic taxes increased about 40%. These successes were the result of employing more tax collectors and, in some cases, raising tax rates. Of greater significance for the future was the comprehensive overhaul of the tax system, an effort designed to increase revenue and to spread the tax burden more evenly throughout the population. Under the six-month emergency powers granted by the National

4. Fertilizer consumption reportedly remained at the 1971 level last year despite the higher prices, the offensive, and bad weather. The higher prices, however, may tend to squeeze Delta rice farmers' profits from the current crop.

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Assembly in June 1972, President Thieu decreed many tax measures that consolidate and simplify the existing tax structure. In addition, a new value-added tax is to go into effect by mid-1973.

17. Most significant of the tax measures are the complete restructuring of the property tax on agricultural lands, new income tax provisions to encourage compliance and broaden coverage, and the new value-added tax.⁵ The revised property tax should result in considerable revenue increases from rural areas where tax collection in the past has been negligible. The income tax law – extended to include all sources of income – substitutes a much simplified single-schedule progressive tax for a multi-rate, low-yield system. Marginal rates for personal income range from 10% to 70%, while the corporate rate is to be 45%. The value-added tax, designed to supplant a heretofore sporadically applied production tax, will be a 10% levy on all goods and services in the economy except exports and government services. Although the administrative details of the value-added tax are not yet clear, preliminary estimates indicate that the annual revenue yields will be on the order of 40 billion piasters (\$86 million), making it by far the largest source of domestic revenues.

18. The new tax reform measures clearly indicate a government effort to increase tax collection through streamlining and modernizing a complex and ineffectual tax structure. These measures will not by themselves eliminate large annual budget deficits, but they will at least provide an efficient framework for significant gains in domestic tax revenues.

Foreign Trade

19. One of the most encouraging developments in 1972 was the sharp increase in commodity exports. After remaining at a level of \$12 million from 1968 through 1971, exports rose to \$23 million last year principally because the government instituted more realistic exchange rates and export subsidies beginning in late 1971.⁶ The most striking increases were reported for forest and fish products, which rose from practically zero in 1971 to more than one-half of total exports last year. The offensive did have an adverse effect on rubber exports, which dropped to about 50% of the 1971 level.

5. Other tax measures covered by the decrees include drastic rate increases on motor vehicles, consolidation of several selective excise taxes into a special consumption tax, revision and simplification of business license and property transfer taxes, a revised single entertainment tax, and a decrease in the number of documents subject to the stamp tax.

6. On 2 January 1973 a fixed subsidy of 50 piasters per dollar's worth of exports was established, replacing the former floating subsidy determined by the difference between the official exchange rate and 500 piasters. This new subsidy plus a 50 piaster subsidy granted most exports last September means that most exports now move at the rate of 565:1. Goods never before sold abroad also receive an additional 25 piaster subsidy for a period of one year.

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20. Commodity exports are still very small relative to imports, which last year amounted to \$694 million according to payments estimates by the National Bank of Vietnam. Imports declined only about 1% in current dollars, but, if the increase in the average dollar price of Vietnam's imports in 1972 is discounted, the decline in the availability of imports is more on the order of 9%. In view of the falloff in demand for capital goods and industrial raw materials because of the recession, a decline of this magnitude is not surprising.

Outlook

21. The outlook for the economy in 1973 rests heavily not only on actual security conditions but also on how the Vietnamese perceive them. The key factor in the economic picture is confidence. If confidence can be restored, then it would not be surprising to see a strong, and possibly rapid, economic recovery in South Vietnam. On the other hand, the wait-and-see attitude on the part of consumers and investors that has prevailed for many months may well continue for several more months until or unless the military and political situation stabilizes. Foreign and domestic private investors are likely to remain cautious despite the attractions of a new investment law and the availability of development loan funds. Capital flight, which apparently resumed in the past few months, probably will continue for a time. Inflation will continue to be a problem throughout the year.

Current Market Developments

22. Despite such potentially disruptive factors as the ceasefire negotiations and the Tet holidays (3-6 February), the retail price level in Saigon has been very stable since early December. Tet buying, which apparently is active, pushed nonfood prices up during the week ending 22 January, but there was an offsetting decline in rice and fish prices.

23. The money markets, on the other hand, have been considerably less stable. For several months, Saigon gold prices have been below those in other Southeast Asian cities, and, as a result, gold reportedly has been smuggled out of the country on a fairly regular basis. In mid-January a single large purchase of gold leaf by a group from Hong Kong sent prices up sharply. Immediately after the group's departure the price dropped, but the quotation on 22 January still was considerably higher than at the beginning of the month - 31,000 piasters per troy ounce (about \$67) compared with 28,900 (about \$62). Black market dollar prices, which increased substantially during early January, held steady the week of the 22nd at 529 piasters per dollar, about 14% above the official exchange rate.

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Communist Economic Plans Following a Ceasefire

24. There are growing signs that in addition to an intensification of the "political struggle" often referred to by President Thieu, a decline in military activity in South Vietnam is likely to bring an increase in competition for access to economic resources. [redacted]

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[redacted] interviews with prisoners of war and ralliers in several areas of the country disclose certain emerging Communist themes on economic issues. The common elements of these reports are directives to: (1) increase and consolidate the Communist economic role in areas under their control; and (2) upset marketing and financial arrangements in selected areas now under South Vietnamese control.

25. The first goal is a natural outgrowth of Communist efforts to substantiate their claims of a major political/administrative presence and apparatus in South Vietnam. In Viet Cong MR 5,⁷ for example, VC finance-economy cadre are to issue plots of land to farmers, provide them with food and tools, and encourage the resettlement and cultivation of abandoned land. In addition, cash loans are to be extended to farmers and fishermen to increase food production and encourage people to remain in, or return to, Communist-controlled areas. The source of these funds is reported to be US dollars received from North Vietnam, which are exchanged for South Vietnamese piasters in local black markets. Reports of similar Communist intentions in other parts of South Vietnam have also been received. For example, Communists in Hau Nghia Province have been instructed to devote their energies to improving living conditions in the countryside following a ceasefire. By building such things as schools and roads, they may hope to persuade large numbers of South Vietnamese to move into their "liberated" areas, as well as to increase their access to local supplies.

26. Communist plans to wage "economic warfare" in areas controlled by the South Vietnamese are somewhat more sketchy. In selected areas, Viet Cong cadre reportedly have received orders to infiltrate urban areas under South Vietnamese control and attempt to upset markets by purchasing goods at inflated prices. Scarcities of particular commodities, greater inflation, and dissatisfaction with the South Vietnamese government are the planned results. Although the methods of achieving these objectives are not spelled out, the Communists are apparently not concerned about the availability of cash, with most of it being expected to come from North Vietnam. Of the two different approaches, the attempt at market disruptions

7. VC MR 5 includes the South Vietnamese coastal provinces of Quang Nam, Quang Tin, Quang Ngai, Binh Dinh, Phu Yen, and Khanh Hoa.

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is likely to have less overall impact. In part, this is because it would require fairly large financial resources - and an extremely efficient administrative structure - in relation to any particular desired effect. Moreover, the South Vietnamese have become inured to recurrent price increases and market disruptions as a result of the war and would be quick to ask the source of the disturbances.

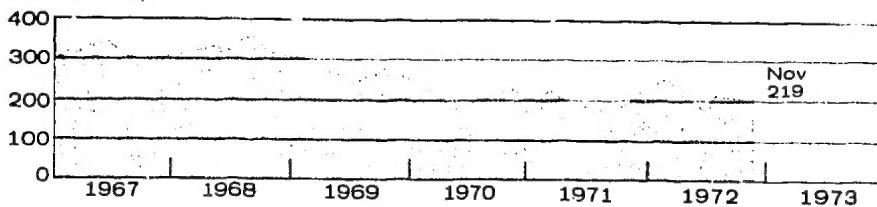
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Figure 1

South Vietnam: Economic Indicators

Foreign Exchange Reserves*

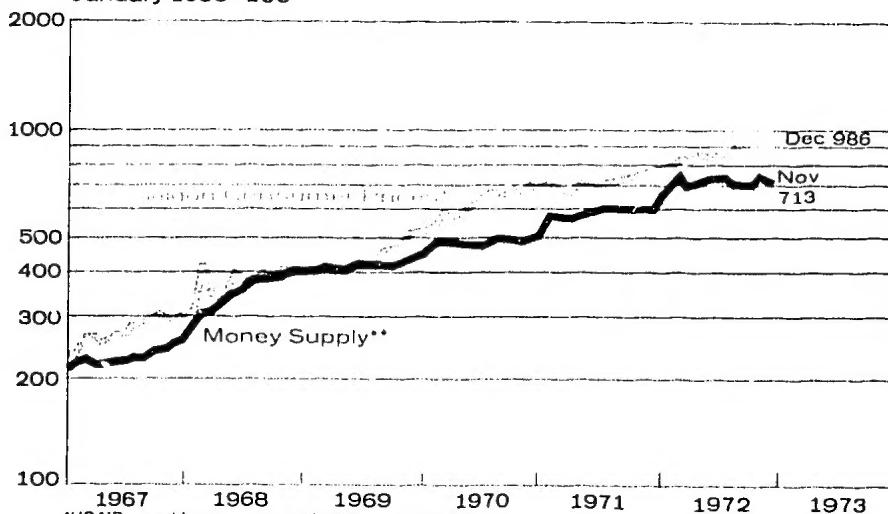
Million US \$



*Consisting of gold and foreign exchange held by the National Bank of Vietnam.

Indexes of Money Supply and Saigon Consumer Prices

January 1965=100

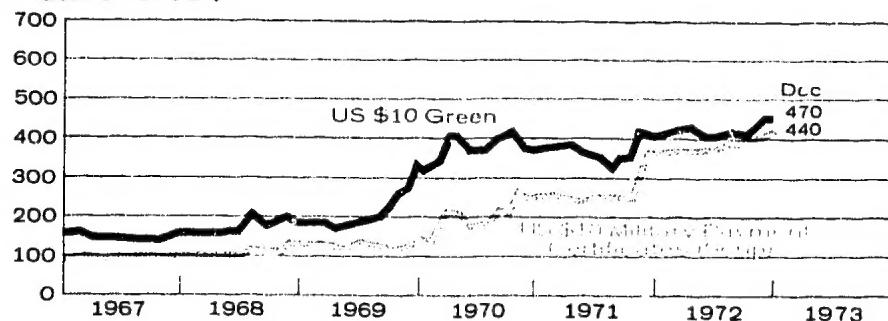


*USAID monthly average retail price index for Saigon.

**Data are for end of month.

Free Market Currency Prices

Plasters Per US \$



Free Market Gold Prices

Thousand Plasters Per Troy Ounce Gold Leaf

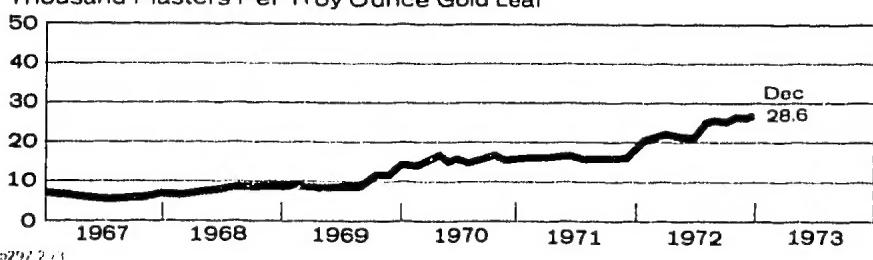
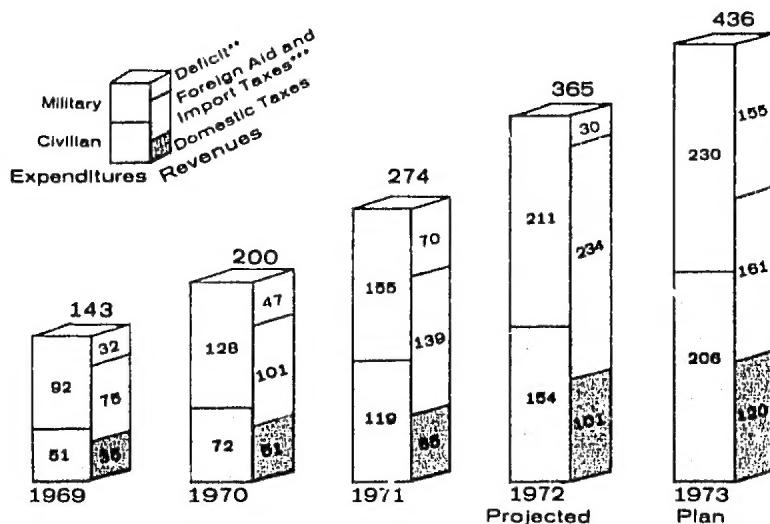


Figure 2

South Vietnam: Government Budget*

Billion Plasters



*Data include extrabudgetary revenues and expenditures.

**Residual. Financed primarily by borrowing from the National Bank.

***Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions.

A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

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